

# EXECUTIVE BRANCH GATT STUDY No. 9

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## THE MOST-FAVORED-NATION PROVISION

COMMITTEE ON FINANCE  
UNITED STATES SENATE  
RUSSELL B. LONG, *Chairman*

STUDY PREPARED BY THE EXECUTIVE BRANCH  
AT THE REQUEST OF  
ABRAHAM RIBICOFF, *Chairman*  
SUBCOMMITTEE ON INTERNATIONAL TRADE



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## **The Most-Favored-Nation Provision**

The unconditional most-favored-nation (MFN) provision is the cornerstone of the international trade rules embodied in the General Agreement on Tariffs and Trade (GATT).

The basic rationale for MFN is that if every country observes the principle, all countries will benefit in the long run through the resulting more efficient use of resources. Furthermore, if the principle is observed, there is less likelihood of trade disputes.

In essence the most important GATT provision on MFN requires a GATT contracting party to grant the products of all other GATT contracting parties the same treatment on importation that it grants to any one of them. A given product of one GATT member will not be placed at a competitive disadvantage as compared with the like product of any third country.

### ***History***

The concept embodied in the MFN clause has been traced to the 12th century, although the phrase "most-favored-nation" did not appear until the end of the 17th century. The emergence of the MFN provision is largely attributable to the growth of world commerce in the 15th and 16th centuries. At that time England and Holland were competing with Spain and Portugal, and the French and the Scandinavians were challenging the Hanseatic League and the Italian Republics. Each country, seeking maximum advantage for its trade, found itself committed until the end of the 17th century. The emergence of the MFN provision was to link commercial treaties through time and between states. At first the MFN provision applied to concessions granted only to specified states, but gradually the clause became generalized to apply to concessions granted to all countries.

The trend toward wide use of the MFN clause necessarily coincided with the decline of mercantilism. The mercantilist view that in any commercial exchange one nation wins and the other loses does not mix with the concept of reciprocal arrangements implicit in the MFN principle.

The unconditional form of the MFN clause—guaranteed equal treatment without requiring directly reciprocal compensation—was used exclusively until the late 18th century. In fact, conditional MFN—equal treatment conditional upon adequate compensation—was inaugurated in 1778 by the United States. During the first half of the 19th century, the conditional form was common in treaties in Europe and

elsewhere. The wave of liberalism that swept Europe in the second half of the 19th century brought a return to use of the unconditional MFN clause in keeping with the free trade sentiment of the time. While European countries ultimately returned to the unconditional form, the United States was consistent until 1923 in its adherence to the conditional form. It should be noted, however, that in practice only a limited amount of United States trade was affected by reciprocal treaties involving conditional MFN. The United States consistently applied a single-schedule tariff to imports from all countries. Reciprocal treaties granting reductions from the general tariff rates were few in number at any given time.

The United States began granting conditional MFN with its first treaty after independence, the United States-France treaty of 1778. Article II provided that, "The Most Christian King and the United States engage mutually not to grant any particular favor to other nations in respect of commerce and navigation, which shall not immediately become common to the other party, who shall enjoy the same favor, Freely, If The Compensation Was Freely Made, Or On Allowing The Same Compensation, If The Concession Was Conditional" (caps added). Similar provisions in treaties with Prussia (1785) and Sweden (1793) served to establish the "American interpretation" that special favors must be specifically bought.

The position of the United States as a newcomer to world commerce largely accounts for its novel interpretation of the MFN clause. With the colonial ties to the British Empire broken, the United States had difficulty establishing an equal footing for trade with other nations. France and Spain, as well as Britain, attempted to exclude the Americans from trading with their overseas possessions. At the same time, these countries sought to penetrate the American market. Given European reluctance to grant initial reciprocity, the United States policy was to establish high duties and grant access to the American market only in return for access to markets controlled by Europe. Under the circumstances then prevailing, the conditional MFN clause enabled the United States to maximize its bargaining leverage by offering no gratuitous access privileges.

The American principle of conditional MFN had a growing effect on commercial policy abroad, reaching its peak roughly between 1830 and 1860. The year 1810 marked the first conditional MFN clause in a treaty between European states (Great Britain and Portugal). In 1824 the clause was introduced to South America, where it remained dominant for the next 25 years. Of all European states, England was the most consistent in adhering to the unconditional MFN form through the first half of the 19th century, although the conditional clause was not uncommon in its treaties during that period.

Beginning with the Cobden treaty between France and England in 1860, the unconditional form of the MFN clause again prevailed in European commercial treaties. The benefits of the Cobden treaty were conditionally extended to other countries by France and unconditionally extended to others by England. It soon became apparent to England that under this arrangement the balance of advantages was in favor of France. To compensate for this, England launched a successful drive to conclude unconditional MFN treaties with other countries. The unconditional MFN clause was used exclusively in Europe after that time, in spite of a return to protectionism on the Continent after 1875.

While the United States and Europe were consistent in following their respective interpretations of the MFN clause during the latter 19th century, practice in other parts of the trading world varied. In South and Central America, for example, both forms of the clause were used with no clear-cut pattern, although the conditional form was used consistently in treaties between American states. Japan also used both forms.

The divergent interpretations of the MFN principle during the late 19th century were largely a manifestation of the economic relationship between the United States and Europe. World War I altered this relationship dramatically. Following the war, the United States no longer stood to Europe as an underdeveloped nation, dependent upon Europe for industrial goods and capital, content to export to Europe its raw materials. American products were now much in demand in Europe and American capital financed European factories. Therefore, in the 1920's United States policy changed, reflecting its broader and more important export interests. By offering complete and continuous nondiscriminatory treatment the United States sought to obtain the same treatment from other countries, thus reducing discrimination against United States exports. Authority for the United States to offer unconditional MFN was included in the Tariff Act of 1922 and implemented in 1923. The Trade Agreements Act of 1934 included an unconditional MFN provision and made it a requirement of United States domestic law.

### **The GATT Provision**

The main GATT provision on MFN, Article I:1 is a direct descendant of the MFN clauses in bilateral trade agreements between the United States and other countries. The provision reads as follows:

"With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with

respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III, any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties."

There are other MFN provisions in GATT in addition to Article I. They apply to such matters as transit, marks of origin, state trading, quotas, the allocation of quotas, and nontariff prohibitions and restrictions. They all require nondiscrimination in these areas.

The benefits to the United States and that part of the world following the MFN principle, particularly since World War II, have been impressive. World trade in 1948 amounted to \$54 billion; by 1958, it had reached \$95 billion, and by 1970, \$280 billion. United States exports expanded from \$13 billion in 1948 to \$43 billion in 1970. A number of other factors were, of course, involved, but adherence to MFN, however qualified as time passed, deserves a good deal of the credit.

### **Exceptions to the GATT Provision**

The GATT recognizes, however, that MFN remains a goal which cannot, in all cases, be achieved. It provides for a number of exceptions. Many are required for practical reasons and, in fact, serve to reinforce the GATT rules. Others were required for political and economic reasons. For example, Article XIV permits discrimination in the application of quotas justified on balance of payments grounds. Article VI allows imposition of countervailing and antidumping duties on subsidized exports or imports sold at less than domestic prices, resulting in injury to domestic industries. Paragraph 2 of Article XXIII allows a country to retaliate against another contracting party which has nullified or impaired benefits under the GATT. Article XXI deviations from MFN are permitted for national security reasons.

The most significant GATT exceptions to MFN are found in two Articles related in one way or another to the issue of preferential trade arrangements. These are Article I: 2 dealing with tariff preferences in force when the GATT was drafted and Article XXIV which provides for the formation of customs unions and free trade areas.

#### ***Article I (Paragraph 2)***

Article I: 2 permits contracting parties which, prior to the GATT, granted or received preferences under a variety of arrangements to continue to do so. It also prohibits any increase in the margins of preference granted or received. United States preferences for the Philippines fall under the provisions of this article, as do Common-

wealth preferences. The provision was written into the GATT when it became clear that the persistent efforts of the United States to bring an end to historical preferences would not succeed. The countries concerned argued that their historic obligations made it impossible for them to accede to an agreement which did not allow them to continue to meet these obligations.

Developed countries have often sought preferences from or granted preferences to their dependent territories or areas over which they exercised political control. These preferences usually have taken the form of preferential tariff rates. They have usually been specifically excepted from unconditional MFN clauses.

The GATT provisions represented an effort to shift away from such preferential arrangements. However, there has been, since 1958 particularly, a proliferation of such arrangements. Some of these do not fall under the historic exceptions, but are in part a reflection of the traditional aid and trade relations that existed before 1948; others do not fall in this category. Most of these arrangements have been justified by the parties as constituting customs unions or free trade areas. In general, however, the United States has contended that they do not conform with the relevant GATT provisions. These arrangements have thus given rise to the controversy between the United States and its trading partners over the most significant exception to the MFN principle, Article XXIV, which allows the formation of customs unions and free trade areas. As far as preferential relationships of the United States are concerned, the one with the Philippines is being phased out, the arrangement with Cuba is inoperative, and the United States obtained a GATT waiver for the auto pact with Canada.

#### ***Article XXIV—Customs Unions and Free Trade Areas***

Article XXIV permits GATT contracting parties to form customs unions or free trade areas from which other contracting parties may be excluded, provided the customs union or free trade area meets the conditions set forth in that Article. A customs union is understood to mean an area in which duties and other trade restrictions are eliminated on substantially all trade between the participants in the customs union. It also permits interim arrangements which lead to customs unions or free trade areas within the meaning of Article XXIV. In addition, substantially the same duties and other trade restrictions must be applied by the members of the customs union to those countries not members of the customs union. A free trade area must meet the first of these two criteria. The Article also contains provisions which were intended to result in as little adverse effect as possible, as a result of the formation of a customs union, on the exports of countries not participating in the customs union. In short, the negotiators intended that GATT contracting parties, which became or were members of a customs union or free trade area meeting the criteria

of Article XXIV, be permitted to apply to the products of the other members of such union or area treatment more favorable than that applied to products of other contracting parties. None of the negotiators could have foreseen the potential for controversy that would arise as a result of the uses to which Article XXIV has been put. The problems which arose were to some extent related to imprecision of language, and to some extent to historical developments.

The customs union exception to MFN treatment was "usual" in commercial treaties by 1933. The rationale at the time was primarily, if not exclusively, a practical one. Customs unions existed, would continue to exist, and the parties to them would not grant MFN to third countries if this meant termination of the customs union. When the GATT was negotiated, customs unions and free trade areas were, for various reasons, considered to be desirable and were put in one category. Preferential arrangements short of a customs union or free trade area were placed in the other category—undesirable. Two negotiating objectives were therefore sought: to tie down the conditions which these desirable agreements would have to fulfill in order to qualify for an exception to MFN, and to eliminate or at least freeze undesirable agreements.

No distinction seems to have been drawn between what were regarded as the beneficial aspects of customs unions and free trade areas. Both were seen as contributing to the movement toward freer trade in that they removed obstacles to competition and made possible a more economic allocation of resources. Governments backing European integration together with certain less developed countries interested in regional arrangements supported this view. The United States position was to insist that Article XXIV contain language to assure the highest possible degree of economic integration. It was believed that otherwise the increased trade with outside countries anticipated as a result of integration would not take place.

But the attempt at precise language to tie down the conditions customs unions and free trade areas would have to meet was not wholly successful. The language of the Article is subject to many interpretations. Almost from the outset, there has been a dispute as to when a proposed customs union or free trade area fully meets the criteria to qualify under Article XXIV. Central to this dispute have been the requirements that acceptable arrangements for free trade areas and customs unions must encompass "substantially all" trade and that the duties and other regulations of commerce applicable to the trade of contracting parties outside the arrangement must not be "higher or more restrictive" than those existing prior to the formation of the free trade area or customs union. Another key issue was how to determine whether interim agreements leading to the eventual formation

of free trade areas or customs unions met the requirement in Article XXIV of a "plan and schedule" for their formation.

### ***Theoretical Basis for the Exception for Customs Unions and Free Trade Areas***

Customs union theory states that the elimination of trade barriers between trading partners will improve world efficiency if the trade creation effect outweighs the trade diversion effects. If the trade diversion effect is paramount, the result will be a decrease in world welfare. Trade creation occurs when the elimination of trade barriers causes a country to shift from its domestic higher cost producers to its partner's cheaper production sources. Trade diversion occurs if the elimination of barriers results in a shift from cheaper output of third countries to the more expensive output of the partner.

Trade creation and trade diversion are inevitable effects of economic integration. Dynamic factors such as improved economies of scale, the stimulus of competition and the influence on investment can result in important gains to customs union members.

Attempts to analyze the experience of viable customs unions such as the European Community in terms of static and dynamic factors have proved inconclusive. The net effect on world welfare as a whole is particularly difficult to determine.

### ***GATT Practice—Customs Unions and Free Trade Areas***

Apart from the existing regional arrangements explicitly excepted from MFN when the text of the GATT was drafted, such as trade between India and Pakistan (Article XXIV:11), thirty-four others have been notified to GATT, not all of them under Article XXIV. Eleven of those operate under waivers granted in accordance with Article XXV:5. In none of the remaining cases did the Contracting Parties take the action under Article XXIV which would have meant disapproval of the agreements; namely that of making recommendations to the parties as to how to bring the agreement in question into conformity with its provisions. In this respect, one of the weaknesses of Article XXIV is that there is no provision requiring approval of such arrangements. Nor did the parties to these agreements seek waivers for the agreements under Article XXV or XXIV:10. Waivers under Article XXV would have permitted the agreements to continue with the sanction of the Contracting Parties without being brought into conformity with Article XXIV. Article XXIV:10 states that the Contracting Parties may by a two-thirds majority approve proposals which do not meet certain Article XXIV criteria provided the proposals lead to formation of a customs union or a free trade area as defined in Article XXIV.

Several types of agreements have been involved. Many of them are regional arrangements between less developed countries. Others cover

relations between former colonies and the metropolitan power which continue or expand traditional trade and aid relationships. Several are agreements between industrialized countries. A few, such as the Greek and Turkish association agreements with the European Community, do not fit any of these categories.

The United States considers that most agreements notified to date under Article XXIV do not meet the requirements of that Article. Although the United States has received some support from other countries its efforts to persuade the majority that this view is correct have generally not been successful. The result of a GATT consideration of such agreements has typically been a disagreed Working Party report on the issue of whether the agreement met Article XXIV criteria for an exception. In some cases the agreements have been made subject to periodic reviews.

The first major agreement presented under Article XXIV was that covering the formation of the European Community. This agreement, unlike many later agreements, contained a schedule for movement toward a customs union as defined in Article XXIV. A series of negotiating sessions took place over tariff levels, particularly on agricultural products. The results were unsatisfactory to the United States. Attempts to use these and later negotiations to deal with agricultural problems were not successful. For many years the European Community reported annually on progress toward a customs union.

In 1968, at the 25th Session of the Contracting Parties, the European Community notified the Contracting Parties that it would not submit any further reports since the customs union had been achieved. The matter was referred to the GATT Council and at the 26th Session in February 1970, the Contracting Parties adopted the Council's report which noted the statement of the Council Chairman that any contracting party could raise any issue on the formation of the customs union on the agenda of the Council or of the Contracting Parties.

The next important exception to undergo examination was the European Free Trade Area (EFTA) agreement. The GATT Working Party reached no conclusion on the compatibility of this arrangement with GATT rules. The EFTA participants took the position that the agreement was fully consistent with Article XXIV requirements. Others, the United States included, argued that the participants had not been able to substantiate this contention. These differing views were recorded at the 17th Session of the GATT in November 1960, when agreement was reached that:

"The Contracting Parties have taken note of the provisions of the Stockholm Convention as well as of the statements made by the representatives of the parties to the Convention to the effect that their governments are firmly determined to establish, within the time-limit

provided for in the Convention, a free-trade area in the sense of Article XXIV.

"The Contracting Parties feel that there remain some legal and practical issues which would not be fruitfully discussed further at this stage. Accordingly, the Contracting Parties do not find it appropriate to make recommendations to the parties to the Convention pursuant to paragraph 7(b) of Article XXIV.

"This conclusion clearly does not prejudice the rights of the Contracting Parties under Article XXIV."

The examination of the EFTA agreement was followed by GATT consideration of the European Community's agreement with Greece and Turkey. The United States position on these agreements was that, although inconsistent with the provisions of Article XXIV at the time they were entered into, the agreements could be expected at some later date to lead to full membership (and at that point they would be consistent with Article XXIV). As NATO allies, closer ties with Europe were very desirable. Furthermore, the effect on United States exports was expected to be very small.

During GATT consideration of these two agreements the United States did not press the issue of consistency with Article XXIV, but did see that concern on this score was reflected in the record. The GATT documents on these agreements contain conflicting views on their compatibility with Article XXIV. The GATT Council noted these views, and no further action other than periodic reviews of the agreements was undertaken.

GATT consideration of other arrangements involving the European Community has also ended in disagreement on the issue of their compatibility with Article XXIV. Included in such arrangements are the agreements of the Community with 18 African countries which are parties to the Yaounde Convention, the agreement with the associated (nonindependent) overseas territories, and the agreements with Morocco, Tunisia, Spain and Israel. GATT discussions of other arrangements of the Community, such as the ones with Malta, Cyprus, Mauritius, and the East African Economic Community (comprising Tanzania, Uganda and Kenya) are still underway. The Community and Turkey have agreed to a major revision of their arrangements, which has not yet been discussed in GATT. The Community has negotiated agreements with the United Arab Republic and with Lebanon.

The problem has been compounded by the enlargement of the Community. Enlargement involves three candidates for full membership (the United Kingdom, Ireland, and Denmark) aligning over a 5-year period their tariffs with the common external tariff of the Community and the elimination of most trade barriers among themselves and between the other members of the Community.

The Community has concluded agreements with those EFTA countries which did not want to become full members, namely Iceland, Norway, Portugal, Sweden, Switzerland, Austria and Finland.

In addition, agreements will be worked out with those developing countries which have historically benefited from preferences, and in some cases have granted reverse preferences, to one or another of the Six or the more recent members of the Community. Reverse preferences are granted by some countries with which the Community already has arrangements and some of the less developed Commonwealth countries.

The existing series of preferential agreements covering relations between the Community and Mediterranean countries were to be applied to the four acceding countries as of January 1973. The United States has made it clear that it does not consider the agreements between Spain and Israel and the Community to be consistent with the GATT, and has expressed its intention to request early consultations, in accordance with appropriate GATT procedures, with the parties to these agreements on their impact on United States exports.

### ***Intra-LDC Regional and Non-Regional Preferential Agreements***

There have been a number of agreements among groupings of LDCs to form common markets, free trade areas or preferential trading associations. Most of these groups have been made up of contiguous states, but more recently, an agreement for preferential tariff reductions was concluded among 16 LDCs located on five continents.

United States policy has been to encourage regional economic integration among LDCs as a means of achieving economic development by lowering barriers and broadening internal markets. The United States has recognized the difficulties for LDCs to adhere to agreements that would fully conform to the requirements of GATT Article XXIV but has nevertheless pointed out that the benefits of integration are most likely to be realized if the associations conform. The United States has, however, adopted a pragmatic approach to this issue. GATT working parties typically have been unable to reach agreed conclusions as to whether the agreements met the criteria of Article XXIV and have required the parties to report annually on developments. The United States has pressed the participants to consider the interests of third parties.

The case of the Central American Common Market (CACM) is illustrative. When Nicaragua, the only CACM country which is also a party to the GATT, reported the signing of an agreement to form CACM in 1960, it was evident that CACM did not conform to Article XXIV criteria. Therefore, Nicaragua requested and was granted a waiver under Article XXV to participate in the agreement and raise some GATT bound tariffs. The terms of the waiver required that Nica-

ragua report annually on the formation of the common market and that the entire Nicaragua GATT schedule would be renegotiated when the formation of a CACM common external tariff is complete. In the meantime, contracting parties could pursue rights to compensation if their trade is damaged.

GATT consideration of the Latin American Free Trade Association (LAFTA), an agreement between 7 (now 11) Latin American countries to establish a free trade area, signed in Montevideo in 1960 followed a pattern similar to CACM. After an examination of the Montevideo Treaty by a working party and the GATT Council, the Contracting Parties at their 17th Session concluded that no decision could be made on the compatibility of the agreement with Article XXIV, that the parties should continue to report developments and that the rights of all contracting parties were not impaired. The decision was not taken in the form of a waiver as was the CACM decision. The United States has consistently supported the establishment and development of LAFTA.

Other intra-LDC regional arrangements reported to the GATT include the Central African Economic and Customs Union, the Arab Common Market and the Caribbean Free Trade Area.

In 1968 India, Egypt and Yugoslavia put into effect an agreement granting each other preferential treatment on about 500 tariff items. The agreement among the three grew out of negotiations among about 20 LDCs initiated in the GATT during the Kennedy Round. Since at the conclusion of the Kennedy Round these negotiations had not produced any agreed concessions among the participants, the three countries decided to conduct separate talks of their own. They hoped that their agreement would serve as a model which the other countries could follow or join. GATT consideration of the agreement, the first case of a preferential arrangement that was nonregional, set an important precedent for further arrangements. In GATT committees the United States took the position that the examination of this agreement should be thorough, to include a study of its consistency with the General Agreement, the contribution that it could be expected to make to the economic development of the participants and the effect it would have on third countries. The GATT Contracting Parties, at the 25th Session, taking into account, among other things, that the agreement was experimental, decided to allow the three countries to implement it, subject to review by subsequent sessions of the Contracting Parties. The United States concurred in this decision.

The three-nation agreement was subsumed into an arrangement among the 16 developing countries in 1971. In that year 16 LDCs completed negotiations held under the auspices of the GATT to exchange preferential tariff reductions among themselves. This agreement was not designed to conform to the requirements of Article

XXIV. Rather, it was an effort to liberalize trade among developing countries. At the 27th Session of the GATT Contracting Parties, the participating countries asked the Contracting Parties for a waiver under Article XXV to allow them to put the agreement into effect. Since the documentation and waiver request was received only immediately before the Session, the United States took the position that the agreement should be examined in a working party, on the grounds that the arrangement did not appear satisfactory in all respects and that not all the terms of the proposed waiver were clear. Furthermore, the matter involved certain new principles and some potential trade problems.

There was no support for this position. A vote was taken and the other contracting parties approved the waiver. The United States abstained.

### MFN and Communist Countries

The United States imposes the statutory (column 2) tariff rates on all Communist countries other than Poland and Yugoslavia. Products of those two countries are assessed at the MFN rates. The denial to Communist countries of tariff reductions stemming from trade negotiations since 1934 originated with Section 5 of the Trade Agreements Extension Act of 1951. The Section directed the President to

"suspend, withdraw, or prevent the application of any reduction in any rate of duty, or binding of any existing customs or excise treatment, or other concession contained in any trade agreement . . . to imports from the Union of Soviet Socialist Republics and to imports from any nation or area dominated or controlled by the foreign government or foreign organization controlling the world Communist movement."

As directed by the statute, the President withdrew all tariff concessions from all Communist countries, except Yugoslavia, which was deemed not included in the statute. In 1960, the President determined that Poland had shown the requisite independence of the international Communist movement required by the statute, and MFN tariff treatment was restored to that country.

Section 5 was superseded by the Trade Expansion Act of 1962 (TEA). Section 231 of the Act required the President to withhold MFN from "any country or area dominated or controlled by Communism." Subsequent to enactment of the TEA, Section 231(b) was added to the TEA to permit exceptions for those countries already accorded MFN treatment if the President determined that the continuance thereof was important to the national interest and would promote the independence of such countries from international Communism. The President determined that such was the case with respect

to Yugoslavia and Poland. The legal effect of Section 231, as amended, was to include among the countries denied MFN treatment, Cuba, the products of which were already denied such treatment under Section 401 of the Tariff Classification Act of 1962.

Since 1963, there have been no legislative changes with respect to MFN treatment for Communist countries. The proposed Trade Reform Act of 1973 contains provisions which would authorize the President to (a) enter into bilateral commercial arrangements to extend MFN treatment to countries now subject to Column 2 rates and (b) extend MFN treatment to countries which become a party to a multilateral agreement to which the United States is also a party, e.g. the GATT. The implementation of such agreements or orders under the proposed Act would be subject to a Congressional veto procedure.

Eastern European countries have shown increasing interest in participation in the GATT. Poland acceded in 1967, Romania in 1971, and Hungary is presently negotiating to join. The accession of Poland did not pose a legal problem for the United States since MFN treatment was authorized for Polish goods. However, when Romania acceded, inability of the United States to extend MFN treatment required it to invoke Article XXXV, which provides that at the time when either of two countries becomes a party to the GATT, either may declare that it does not consent to application of the provisions of the GATT between the two. If Hungary accedes the United States will be obliged to invoke Article XXXV again unless Congress meanwhile authorizes extension of MFN.

### **MFN and Non-GATT Members**

The United States, as required by law, grants MFN treatment to all free world countries, whether members of GATT or not. Most Western countries follow the same practice.

While a number of countries are not GATT members, some among them have accepted GATT obligations, including MFN. Together with the members of GATT, these countries number 96 and their trade accounts for between 80 and 90 percent of total world trade.

### **The Generalized Preferences Waiver**

A recent important derogation from the MFN principle is the generalized preferences waiver, which was approved by the GATT Contracting Parties on June 25, 1971.

Mutually acceptable arrangements to grant nonreciprocal trade preferences to LDCs were drawn up over a period of years in the Organization for Economic Cooperation and Development and in the United Nations Conference on Trade and Development. Congressional author-

ization is required in order for the United States to participate, and this has been requested in the proposed Trade Reform Act of 1973. The Government of Canada has obtained Parliamentary approval but has not yet implemented a general preference system. All other major trading countries have put their systems into effect. These systems result in discrimination in favor of the LDCs, as opposed to the industrialized countries, and therefore are inconsistent with the MFN obligations of the contracting parties contained in GATT Article I. Through GATT action these obligations were waived for a period of ten years in order to permit the granting of generalized preferences.

### ***Recent Developments***

Because of concern over the proliferation of preferential arrangements, the United States proposed at the 27th Session of the Contracting Parties in November 1971, that: (1) a schedule be established for the Council to examine reports of countries participating in customs unions, free trade area arrangements and interim arrangements; and (2) the Contracting Parties establish a working party to examine existing and prospective preferential and special trading arrangements to determine the total imports at MFN and at preferential rates for each GATT member and for GATT countries as a whole in the 1955-1970 period. The United States also proposed that the working party analyze and evaluate the trends and the implications of the trade flows at MFN and preferential rates based on this data.

On the first United States proposal the Contracting Parties instructed the Council to establish a calendar fixing dates for the examination, every two years, of preferential arrangements. The Council subsequently approved a timetable for reporting dates.

On the second United States proposal, the Contracting Parties decided that the Director General of the GATT, with guidance from a working party, would undertake the statistical study but would limit it to representative years in the 1955-1970 period. Preliminary statistical findings by the GATT Secretariat were released in June 1972 on a restricted basis. The data confirm the U.S. contention that a significant percentage of world trade is now subject to preferential duty rates—about 25 percent if intra-EC trade is included. Further analysis has been temporarily deferred because of the heavy workload of the Secretariat in the context of the forthcoming multilateral trade negotiations.

